Peter Ferrara
ON THE CUTTING EDGE

OP/ED

The Anachronism Of State Income Taxes

Mar. 9 2011 - 5:11 pm | 329 views | 0 recommendations | 7 comments

Image via Wikipedia

Nine states survive perfectly well with no state income tax at all. These include large states such as Texas and Florida, medium-size states such as Tennessee and Washington, and smaller states, in terms of population, such as New Hampshire, Nevada, South Dakota, Wyoming, and Alaska. This policy should now be extended to the other 41 states.

Income taxes are the most economically destructive of all taxes. That is because income levies tax directly the reward for work, savings, investment, and entrepreneurship. With the reward reduced, the incentive for pursuing these economically productive activities is reduced. The result is less work, less saving, less investment, fewer new businesses, less business growth, less job creation, lower wages and income, and lower overall economic growth.

Higher marginal tax rates reduce these incentives more. Lower marginal tax rates reduce these incentives less. A marginal tax rate of zero, as with no income tax, maximizes these incentives, at least as far as the burden of income taxes is concerned.

High income taxes also cause high wealth and net income individuals to leave greedy states for more favorable tax climates, particularly the states with no income taxes. The original state then loses all the tax revenue from these fleeing high wealth taxpayers.

Experience and economic studies bear this out. The latest work was produced by Art Laffer, Steve Moore and Jonathon Williams in their annually recurring volume *Rich States, Poor States*, published by the American Legislative Exchange Council (ALEC).

Economic growth, as measured by Gross State Product, in the nine states without income taxes raced ahead from 1998 to 2008 almost 50% faster than in the nine states with the highest top personal income tax rates. Job growth, as measured by non-farm payroll employment, rocketed ahead more than twice as fast in the nine no-income-tax states as compared to the nine top income-tax-rate states. Yet, total state tax receipts in the nine no-income-tax states still grew 30% *faster* than in the top tax-rate states.

The authors then went on to look at the economic performance of the 11 states that adopted a state income tax in the last 50 years. All 11 states grew more slowly than the rest of the country after adoption of the income tax. Moreover, per capita income relative to the U.S. average declined substantially after adoption of state income taxes in all 11 states. As the authors state, "Personal income per capita is the closest measure to be found that represents the state's standard of living; gross state product is the truest measure of a state's output." What the results show, as the authors explain, is that in each state that has adopted a state income tax in the last 50 years, "the state's economy has become a smaller portion of the overall U.S. economy, and the state's citizens have had their standard of living dramatically reduced."

Yet, in nine of the 11 states, after adoption of the state income tax, total state and local tax revenues in the state as a percent of total state and local revenues in the U.S. declined as well, in some cases sharply.

The authors further contrast the economic performance of Tennessee, with no state income tax, with the performance of Missouri next door. From 1998 to 2008, Tennessee's Gross State Product grew 27% faster than Missouri's, while jobs grew 29% faster in Tennessee. Yet over that period, total state revenues generated by Tennessee's faster growing economy grew 39% faster than Missouri's.

If Missouri's economic growth just caught up to the average of the states with no income tax, which are growing 50% faster, Missouri would enjoy $100 billion in increased state GSP and income over the next 10 years. From 1998 to 2008, the average job growth among the no income tax states was 349% (more than four times) faster than in Missouri. The growth in GSP per capita, or standard of living, was 80% faster. If GSP per capita over 1998 to 2008 had grown in Missouri at the same average rate as for the no income tax states, income for each Missouri resident would be more than $12,000 higher on average.

Texas, with no state income tax, can also be contrasted with California. While the top personal income tax rate in California is now 10.55%, even the average income earner pays a marginal income tax rate on the next dollar earned of 9.3%. Moreover, even the sales tax rate is higher in California at 8.25% than in Texas at 6.25%.

Even with all of California's advantages as a land of beguiling climate, movie stars, beautiful Pacific beaches, unsurpassed natural Pacific ports, and the economically path-breaking Silicon Valley, since 1998 the rate of real economic growth in Texas has been almost 20% higher than in California. Since the end of the tech boom and the 9/11 recession, the rate of real economic growth in Texas has been astoundingly almost 50% higher than in California.

From 1998 to 2007, real personal income in Texas grew 21% faster than in California. Since 2002, the gap has widened, with real personal income growing 46% faster in Texas. Moreover, since the end of the tech boom and the 9/11 recession, jobs in Texas have grown more than twice as fast as in California.

Starting with the Gold Rush of 1849, California has been the destination of choice for Americans, with migrants coming originally in wagon trains over thousands of miles, then by railroad, by plane, and finally by car over interstate highways. But no more. Over the decade 1998-2007, 1,438,480 Americans fled California on net. Texas, by contrast, enjoyed net interstate migration during that time of over one half million, the third highest behind Florida and Arizona.

The phenomenon of Americans voting with their feet to flee high taxes is not limited to California. It is happening all over America, and has been for quite some time. The Center for Fiscal Accountability of Americans for Tax Reform regularly reports IRS data regarding interstate migration of taxpayers. The Center reports that from 1997 through 2007 the 10 states with the highest tax burden lost over 3 million residents. Those residents took with them during that period a staggering $82 billion in income.

Yet, the nine states with no income tax enjoyed during that same period a net in-migration of over 2.6 million residents from the other 41 states, bringing with them nearly $100 billion in additional income. Laffer, Moore and Williams report that from 1999 to 2008 population in the nine states with no income taxes grew 152% faster than in the nine states with the highest income tax rates.

The key tool to achieve the phase-out of state income taxes in every state is known as the Taxpayer Bill of Rights, identified with the acronym TABOR. Colorado voters adopted a TABOR in 1992, which limits growth in state taxes and spending to the rate of growth of population plus inflation. The state government is required to rebate annual tax revenue increases in excess of this limit back to the taxpayers. From 1997 to 2007, a cumulative total of $6.7 billion was rebated to taxpayers.

Jobs in Colorado grew twice as fast in the 10 years after TABOR was adopted as in the 10 years before. Per capita personal income also grew twice as fast in the 10 years after TABOR. In the 14 years before TABOR, per capita income growth in Colorado was below the national average. In the 14 years after TABOR, per capita income growth was almost 20% (19.3%) higher than the national average.

TABOR provides a reasonable limit on state spending. Spending rising at the rate of population growth and inflation means the same amount of spending can be maintained per person in real terms over time. That would prevent government spending from growing faster than the economy, and becoming a bigger relative burden over time.

If a state just holds spending growth to the TABOR limit, and devotes the savings each year to reducing income tax rates, then enough savings would be generated along with new revenues from the resulting economic growth to phase out the state's income tax completely in less than 10 years. That would apply to the state individual income tax, the state's corporate income tax, and the state's capital gains tax, the latter two usually not raising a lot of money. This can be demonstrated in particular studies for each state using that state's own data on taxes and spending, like the study I did last year for the Virginia Institute for Public Policy.

With the burden of state income taxes lifted, economic growth in the states would soar, new jobs would be created, and wages and incomes would rise, as indicated by the discussion above. Revenues from the remaining taxes would rise more rapidly as well, along with the booming economy, as the results discussed above also showed. After state income taxes are phased out, the TABOR spending limit should remain to ensure that state spending doesn't get out of hand again in the future.

This would be an ideal project for Tea Party activists in each state across the country.

Peter Ferrara is Director of Policy for the Carleson Center for Public Policy, a Senior Fellow for the Heartland Institute, and Director of Entitlement and Budget Policy for the Institute for Policy Innovation. He served in the White House Office of Policy Development under President Reagan, and as Associate Deputy Attorney General under the first President Bush. He is the author of America's Ticking Bankruptcy Bomb: How the Looming Debt Crisis Threatens the American Dream, and How to Turn the Tide Before It Is Too Late, *forthcoming from HarperCollins, which discusses this issue in more detail.*

Previous Post:
Gutting Medicare By Refusing To Pay The Bills

More on Forbes Right Now

Related Posts

Are Tech Companies Over-Taxed?

Economic Data Friday

Election Night Tax Advice: Before You Accelerate Income, Move

Tax Foundation Report: How The Expiration Of EGTRRA Impacts State Estate Taxes

Should Income Taxes Be Only For The Rich?

Comments